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STATE/H FOR ANDREW MACDERMOTT, PATRICIA DIGGS

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SUBJECT: SCENESETTER - CODEL DORGAN VISIT TO SEVILLE, SPAIN
DECEMBER 18-19

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¶11. (SBU) Summary: Embassy Madrid warmly welcomes your visit. You will be visiting Spain during a severe economic downturn, its first in 15 years. Spain has become a leader in the development of renewable energy - particularly wind power - as the result of implementing feed-in tariff subsidies. Several Spanish companies, including Abengoa, whose solar tower plant you will visit, are among the world's largest renewable energy companies. Cooperation on renewable energy is an increasingly important part of our bilateral relationship. As expected, Spanish renewable energy companies reacted favorably to the extension of U.S. renewable energy tax credits as part of the Emergency Economic Stabilization Act of 2008. End Summary.

Tough Times for Economy, Zapatero

¶12. (SBU) President Zapatero's Socialist party (PSOE) narrowly defeated the conservative Popular Party (PP) in general elections last March. The PSOE gained seats in Congress but fell just short of an absolute majority, forcing it to barter with small regional parties and the United Left party to pass legislation. Foreign affairs did not play a major role in the campaign, but the PSOE reminded voters that it removed Spain's troops from an unpopular war in Iraq.

¶13. (U) Since Zapatero was re-elected, the GOS has faced a deepening economic slump. After 15 years of rapid economic growth, the end last year of a long construction boom has led to surging unemployment, now almost 13 percent. Inflation reached a high of more than 5 percent earlier this year, but has recently dropped to 2.4 percent due to the drop in oil prices and the economic downturn, spurring concerns over possible deflation next year. The economy is almost certainly already in recession, having contracted 0.2 percent in the third quarter of 2008; 2009 is expected to be an even more difficult year. Months of worse-than-predicted economic news have led to widespread criticism of Zapatero and his economic policymakers for their upbeat predictions during the campaign and for having downplayed the economic difficulties long after many others were saying Spain was in a crisis.

¶14. (U) Spain's banks have so far weathered the international financial crisis of the last few months better than their counterparts elsewhere in Europe. Conservative regulation by the Central Bank meant that they had high provisions against losses, and almost none had invested in U.S. mortgage-based securities. However, Spain's domestic property crash has left banks with bad construction and real estate loans, rising unemployment has contributed to increased delinquencies, and the country's very high current account deficit makes it dependent on crossborder lending that is now scarce. Spain has announced bank support

measures like those elsewhere in Europe, including asset purchases, guarantees for new debt, and possible capital infusions. The GOS announced on November 27 plans for 11 billion euros in additional spending including 8 billion for municipal government infrastructure projects.

¶15. (U) The medium-term economic picture remains reasonably favorable. Spain has the world's eighth largest economy and is the second largest international tourism destination and eighth largest auto manufacturer. By one way of measuring, its per capita GDP is expected to pass Italy's in 2010. In the bilateral economic relationship, investment is more important than trade. U.S. investment has played an important role in the Spanish economy for decades, and U.S. firms employ over 200,000 Spaniards. Spanish investment in the U.S. has surged in the last few years, particularly in renewable energy, banking and toll road construction. In 2007, Spain was the fourth largest foreign investor in the U.S.

Bilateral Cooperation and Security

¶16. (SBU) U.S.-Spain relations were seriously damaged by President Zapatero's decision immediately after his election in 2004 to abruptly withdraw Spanish forces from Iraq. However, over the last several years, both countries have made a concerted and successful effort to rebuild the relationship based on strong mutual interests in counter-terrorism, fighting narcotics trafficking and organized crime, and rapidly expanding economic ties. Following the March 11, 2004 train bombings in Madrid, Spain remains a target of Islamic extremists. Al-Qaeda leaders often call for the recapture of the medieval "Al Andalus,"

and the uncovering in January of a cell allegedly sympathetic to Al-Qaeda and operating out of Barcelona has shown the public that this threat is not an idle one.

¶17. (SBU) Spain is no stranger to terrorism, having fought the domestic Basque terrorist group ETA for almost 40 years. ETA has been weakened by a series of arrests stemming in part from improved cooperation from France. Last month, French police arrested ETA's presumed leader and military chief in Cauterets, France; earlier this year, Spanish police arrested the organization's political leader. However, ETA retains the capacity for violence and has carried out several small-scale bombings and killed four people this year.

¶18. (SBU) Narcotics trafficking is another area of common concern and excellent cooperation. Spanish authorities acknowledge that Andean cocaine is a serious problem here, and Colombian trafficking organizations are active in Spain. Money laundering is another serious issue. We are increasing bilateral cooperation and encouraging Spain to continue engaging more aggressively with law enforcement authorities in key Latin American countries. Second only to the U.S. in terms of investment in Latin America, Spain is actively engaged in the region, both politically and economically.

¶19. (SBU) Spanish military cooperation matters. The bases of Rota and Moron are strategic hubs, midway between the U.S. and Afghanistan and Iraq. U.S. planes and ships account for around 5,000 flights and 250 port calls a year in Spain. Spain has nearly 800 personnel in Afghanistan and runs a provincial reconstruction team in Badghis province. Spain has nearly 1,100 troops with UNIFIL in Lebanon and about 700 in Kosovo.

Oil, Gas and Electricity

¶10. (U) Although Spain is not dependent on Russian gas like many European countries, it does rely on imports for almost all of its oil and gas, so energy security is a significant concern. Spain imports oil from a variety of suppliers,

including Russia, Mexico and the Middle East. Last year, no one supplier provided more than Russia's 22 percent of Spain's oil. About 70 percent of Spain's gas is imported as liquefied natural gas. However, nearly all of the imported pipeline gas and almost a third of Spain's total gas imports come from Algeria, leaving the country uncomfortably dependent upon one source. Other main suppliers include Nigeria, Persian Gulf countries, Egypt, and Trinidad & Tobago.

¶11. (U) In recent weeks, Russian oil company Lukoil (partly owned by the U.S. firm ConocoPhillips) has sought to acquire up to 29.9 percent of Repsol, Spain's largest oil and gas company. GOS officials, including President Zapatero, publicly opposed reported interest by the Russian government-owned Gazprom, but Zapatero has supported Lukoil's interest, saying the GOS "will not interfere" and referring to the negotiation as "an issue between two private companies." Spain's conservative opposition Popular Party has been vocal in its opposition to the sale, which would make Lukoil the former national oil company's single largest shareholder. Media reports indicate that Repsol and Lukoil have agreed to the GOS' requirement that Repsol continue to be directed by Spaniards, with Lukoil controlling 4 of Repsol's 16 board seats with up to 29.9 percent of the company's equity.

¶12. (U) The rapid economic growth of the last several years has led to a steady increase in electricity consumption. The main electricity sources are gas, nuclear, coal, wind power, and hydroelectricity, in that order. The use of gas has grown rapidly in recent years and now accounts for around 40 percent of generation. Nuclear production is around 20 percent of generation and has remained roughly constant in recent years; President Zapatero and the ruling PSOE party oppose new nuclear power plants and have committed to closing Spain's existing plants as their useful lives end. Coal-powered generation has fallen dramatically (down 39 percent in the first 9 months of 2008) for price reasons including the added cost of CO₂ emissions permits. It has accounted for a little over 15 percent of generation this year. Wind generation is growing steadily and now accounts for over 10 percent of the total. There are no new large-scale hydro projects, and hydroelectric generation varies from year to year with changes in annual rainfall levels. In this relatively dry year, it has accounted for around 8 percent of generation. Solar and other forms of generation are still relatively minor sources of current generation, although investment in solar has boomed in the

last couple of years.

Renewable Energy Increasingly Important

¶13. (U) Renewable energy is an increasingly important part of the Spanish economy and of our bilateral relationship. Abundant wind and sun, and generous feed-in tariffs, have helped make Spain a world leader in wind and solar power. Iberdrola is the world's largest producer of wind power, and Acciona is the third largest. Gamesa, partially owned by Iberdrola, is one of the world's largest manufacturers of wind turbines and also operates wind farms. Spain is also the world's third largest generator of solar power and has undergone a boom in both photovoltaic and concentrated solar projects; the GOS is particularly optimistic about the potential for cost reductions in concentrated solar projects like Abengoa's Solar Tower that you will visit.

¶14. (U) Spain's feed-in tariff system provides very high, guaranteed, inflation-adjusted tariffs for the life of the project for the first few hundred megawatts (MW) of projects that use a particular technology. Future projects receive lower guaranteed tariffs. For example, photovoltaic projects connected to the grid by September 29, 2008 qualified for tariffs of over 40 cents of a euro per KWh. The first 367 MW of ground-based PV projects connected before the end of 2009

will receive a still-generous 32 cents. The steady decline in wind generation costs is an example of how the system has worked. The guaranteed tariff for new wind power projects is around 7 cents/KWh, not much above the cost of other means of generation. The high tariffs are designed to be factored into overall consumer electricity bills; the volumes are small enough that the increase would be only around 8 percent so far. U.S. companies are benefiting from Spain's system both by investing in (e.g., AES) and by supplying (e.g., GE and other U.S.-based firms) renewables projects in Spain.

¶15. (U) A factor complicating Spain's feed-in tariff system is that for the last several years, the GOS has not passed on the full cost of electricity to consumers and is building up a debt to generators for the remainder. Although rates have increased more than inflation this year, bills are still around 20 percent below actual cost. This is a matter of contention between the generators and the GOS, but it has not affected renewables policy discussions.

¶16. (U) Spanish renewables companies see the U.S. as an increasingly important market. Spanish companies own wind farms in at least 17 U.S. states and continue to expand. Iberdrola's multi-billion dollar acquisition of Energy East, which closed in September, reportedly was delayed over the company's insistence that New York regulators allow it to keep Energy East's wind assets. Iberdrola plans to invest as much as \$11 billion in U.S. renewables in the next few years.

Gamesa and Acciona own four wind turbine manufacturing plants in Iowa and Pennsylvania. Gamesa has wind energy projects operating or under construction in 18 states. Acciona owns the world's third largest solar plant, the 64-MW Nevada Solar One concentrated solar (parabolic trough) facility. Abengoa Solar, which will be hosting you for a tour of its Solar Tower plant in Sanlucar la Mayor, is building a 280-MW concentrated solar (parabolic trough) plant in Arizona, which will be the world's largest of its kind. The plant, expected to begin operating in 2011, will supply electricity to Arizona Public Service.

¶17. (U) Abengoa Solar has received five contracts from DOE and NREL over the last year to develop parabolic trough and power tower technology. Abengoa has also been awarded DOE grants for second-generation ethanol projects. As of the end of 2007, Abengoa Bioenergy is the fifth largest producer of Bioethanol in the United States with 110 million gallons of installed capacity. The company currently has biofuels operations in 7 U.S. states.

Bilateral Engagement

¶18. (U) In February of 2008, Embassy Madrid and the Spanish government organized a visit to Washington and Colorado for a renewable energy delegation of Spanish government and business leaders including Santiago Seage, CEO of Abengoa Solar. The group participated in meetings with federal, Senate, and state officials, business representatives, and the National Renewable Energy Laboratory. The delegation, led by Ambassador Aguirre, met with Senators Craig, Domenici, Grassley, Martinez, Salazar and Thune, and several staff members.

¶19. (U) Two issues that may come up in your meeting with Abengoa are U.S. investment and production tax credits for renewables and U.S. biofuels subsidies. Throughout 2008, Spanish companies have repeatedly raised with Congressional delegations and USG officials the importance of renewing tax credits. In fact, Abengoa's planned 280 MW concentrated solar plant in Arizona was contingent upon the extension of federal tax credits. Companies were pleased with the 8-year extension of credits for solar energy included in the financial sector rescue legislation, though we have not heard reactions to the one-year extension of wind credits. Press reports have indicated that the same legislation eliminated the "splash and dash" incentive that had sparked U.S. exports to Europe of imported biofuels but extended the biofuels

subsidy that also encourages U.S. exports. GOS officials have expressed interest in confirmation of the measures and their impacts.

Climate Change

¶20. (SBU) Climate change is one of the signature issues of the Zapatero Administration and one reason the GOS is so supportive of renewables. The Socialist government has firmly embraced the Kyoto Protocol, under which Spain committed to reduce greenhouse gas (GHG) emissions to 15 percent above 1990 levels by 2012. Despite generally popular initiatives to promote renewables and energy efficiency and to implement EU commitments, emissions are currently 50 percent above 1990 levels, in part because of years of rapid economic growth. Spain is the EU country most out of compliance with Kyoto and will not meet its 2012 commitment. That said, Zapatero remains committed to fighting climate change and, despite the economic slowdown, may be willing to commit to costly actions if necessary.

Personal Security

¶21. (U) In general, Spain is safe. However, large cities attract a large number of criminals and pickpockets and frequent incidents of crime of opportunity against the unwary do occur. It is best to carry only essential items including a photocopy of your passport's photo page. Visitors can protect themselves against crime by being street-smart, alert and aware of their surroundings. Travelers are encouraged to review the most recent Worldwide Caution issued by the Department of State. As the Department of State continues to develop information on any potential security threats to Americans overseas, it shares credible threat information through its Consular Information Program documents, available on the Internet at <http://travel/state.gov>. Additional information regarding safety and security in Spain is available on the U.S. Department of State's website (www.embusa.es).

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